

Tax News

April 2008

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California's treatment of the federal rebates

The IRS will begin sending Economic Stimulus Payments (rebates) in May. Eligible taxpayers must file a 2007 **federal** tax return to receive the rebate. FTB has already received inquiries about how the federal rebates will affect California taxpayers. Here are answers to two frequently asked questions about how California will handle the rebate:

1. Will California tax the federal rebate?

No. This question was first answered in 2001, when federal rebates were issued as part of the Economic Growth and Tax Relief Reconciliation Act. As was true in 2001, the 2008 federal rebate is **not** taxable by California, based on FTB's legal ruling of 2001 combined with the amended Internal Revenue Code.

For more information, see FTB legal ruling [2001-3](#) and the [IRS answers](#) to frequently asked question about the stimulus payments [rebate questions](#).

2. If my clients are required to file federal tax returns in order to get the rebate, are they also required to file California tax returns, even if they normally do not?

No. They should **only file** a 2007 California tax return **if** either of these conditions applies:

- Their income is above the [filing threshold](#) for California.
- They are [otherwise required](#) to file a 2007 state return.

McClintock Appeal update

The [November 2007](#) issue of *Tax News* included an article regarding the State Board of Equalization (SBE) unpublished decision in the Appeal of Jessica McClintock. Specifically, that article stated that individuals with a documented barrier, as defined under the Job Training Partnership Act (JTPA) 10 percent exception category, could be considered qualified employees for purposes of the enterprise zone hiring credit.

Based on information available at the time of the hearing, the SBE determined that "older worker" was a documented barrier for purposes of the JTPA 10 percent exception, regardless of the individual's economic situation. Since then, Franchise Tax Board (FTB) as obtained Employment Development Department Directive 96-5 that provides program administration information to JTPA administrators, and discusses when an older worker is eligible for JTPA services. This Directive requires that an older worker must be **both** 55 years or older, **and** meet low-income guidelines.

FTB has presented this new information to the SBE and requested affirmation that for purposes of the enterprise zone hiring credit, "older worker" as a documented barrier also requires that

the individual meet low-income guidelines. We will include information in *Tax News* on any future updates on this appeal.

2007 Income Tax Expenditure report

Interest in tax expenditures is never low – but the interest level soars when the state grapples with a significant budget deficit. In December 2007, we released our *Income Tax Expenditures Report*, which is a listing of all tax expenditures, and a comprehensive analysis of their revenue effects.

The term “tax expenditure” comes from a definition in federal law:

Revenue losses attributable to provisions of the federal tax laws that allow a special exclusion, exemption, or deduction from gross income, or which provide a special credit, a preferential rate of tax, or a deferral of tax liability.¹

The report considers only tax expenditures in California Corporation Tax, and California Personal Income Tax (PIT). PIT and Corporation taxes collected by FTB comprise 65.6 percent of the General Fund (*Franchise Tax Board Annual Report 2006*). The report’s analysis of specific expenditures is divided into the major categories of conformity and nonconformity expenditure items. The largest expenditure in the nonconformity category is exclusion of Social Security benefits, at \$1.74 billion. Under conformity items, the top tax expenditure is exclusion of employer contributions to pension plans, at \$4.9 billion.

Tax expenditures are further defined in relation to “normal income tax structure,” as provisions that reduce tax relative to “normal tax law.” Justification for tax expenditures is placed under two broad policy objectives: equity and behavioral incentives.

Equity

Tax expenditures are used to enhance the equitable nature of the tax system by providing relief to a group of taxpayers who incur monetary costs that are unusual to taxpayers as a whole. For example, blind taxpayers may claim the additional exemption for blindness. The function of the blindness exemption is to restore equity by compensating taxpayers for expenses specifically related to their blindness.

Behavioral incentives

Tax expenditures exist for a wide variety of behavioral incentives. They are designed to modify behavior in ways deemed by the Legislature to benefit taxpayers as a whole; behaviors that would probably occur less frequently if the behavioral incentives did not exist. For example, the tax credit for carpooling is intended to ease traffic congestion and reduce polluting emissions by reducing the number of vehicles on the roads. These outcomes benefit taxpayers as a whole, but individual taxpayers who decide to carpool might find the tax credit more persuasive than the greater public good. The outcome remains the same, however.

¹ Congressional Budget and Impoundment Control Act of 1974 (P.L. 93-344), Section 3(3).

The full *Tax Expenditure Report* is available on our Website at ftb.ca.gov (search for “tax expenditure”). In addition to listing all tax expenditures and their costs, the report examines tax expenditures from various perspectives. It provides necessary context with discussion of “normal tax law,” policy motivations, administrative issues, and the disadvantages of, and alternatives to tax expenditures.

The top 10 PIT errors that delay return processing

Just in time for the filing season crunch, we offer FTB Publication *Top 10 Personal Income Tax Errors that delay return processing 2007(761PIT)*:

Category	Error	Solution
Amended return	Incorrect amount was transferred from the original return to the amended return.	Transfer all amounts from the original return to the amended return carefully and accurately.
Deductions	Standard or itemized claimed on the return has been revised to the correct amount based on the filing status used or to correct a math error.	Refer to the instructions to determine the correct amount to deduct.
Estimated tax payments	Amount of the estimated tax payments claimed on the return does not equal the amount received.	Check client records to accurately report the estimate payments paid to FTB. You can verify the estimated tax payments received by going to our Website at ftb.ca.gov and searching for <i>My FTB Account</i> .
Estimated tax transfer	Amount of estimated tax transfer requested on the return was adjusted due to an error on the return.	Check client's return and all calculations for accuracy before requesting to transfer your overpayment to the next year.
Excess SDI	Amount of excess State Disability Insurance (SDI) or Voluntary Plan Disability Insurance (VPDI) credit claimed on the return was not substantiated by the Form W-2 or other wage document attached to the return.	Review the instructions to determine if your client is eligible to deduct excess SDI. Attach all required documentation.
Exemption credits	Amount of exemption credits claimed on the return was revised because the exemption amount claimed was either subject to adjusted gross income	Refer to the instructions to determine the correct amount of exemption credits to claim based on your client's specific

Category	Error	Solution
	limitations or incorrectly computed or transferred.	circumstances, filing status, and adjusted gross income. Verify all calculations for accuracy.
Payments and credits	Payments and credits were incorrectly added or the total payments and credits were incorrectly subtracted from the total tax.	Review calculations to make sure they are accurate.
Renter's credit	Nonrefundable renter's credit was revised or disallowed because (a) the wrong amount was claimed based on the filing status used, (b) the California adjusted gross income exceeds the qualifying maximum amount, (c) part-year residents' renter's credit is prorated, or (d) nonresidents do not qualify for renter's credit.	Review the instructions to determine if your client is eligible to claim renter's credit on his or her return. If eligible, make sure to calculate the amount of the credit accurately.
Tax	Total tax reported on the return was revised due to (a) an error calculating the tax liability or total credits, (b) the taxable income reported and/or the filing status used, or (c) the exemption credits claimed.	Review calculations to make sure they are accurate. Make sure you use the correct tax table, row, and column for your client's income and filing status.
Withholding credits	Amount of withholding credits claimed on the return does not equal the total amount shown on the attached withholding documents.	Add all withholding amounts accurately and substantiate all amounts claimed with the appropriate documentation.

FTB's top twelve tax scams

Here is another useful [list](#) to help get you through the filing season. As we approach April 15, we see increasing numbers of swindles and schemes for avoiding tax, or claiming unearned refunds. Unfortunately, these scams are often promoted and carried out by unscrupulous tax preparers. During filing season, and all year long, FTB vigorously seeks out and exposes fraud. This not only supports equity and the revenue base, it also serves to safeguard the reputations of scrupulous and ethical tax practitioners, who make up the majority of the tax professional community.

We use a comprehensive approach for finding and stopping illegal scams. For example, we work with the California Tax Education Council (CTEC) to inform tax preparers that they must be registered in California if they are not CPAs, enrolled agents, or attorneys. To become

registered, they must complete the requirements, or face a minimum \$2,500 penalty (increased to \$5,000 if they don't comply within 90 days). On another front, our Fraud Prevention and Detection, and Investigations units are vigilant in finding wrongdoers. Our automated return processing system detects multiple returns filed under the same Social Security Number, "refund mills," etc.

We now also have a publication that can alert the public to the shady schemes they should be aware of, and avoid. You can download the publication, *Franchise Tax Board Top Twelve Tax Scams* ([FTB 987](#)), from our Website at ftb.ca.gov. It can provide a quick reference for your clients on what they should avoid, and why. The FTB list of top 12 tax scams is similar to the IRS "[Dirty Dozen](#)," but not identical. Here is our list:

1. Tax shelters.
2. Credits and incentives.
3. Phony home-based business.
4. Internet businesses.
5. Offshore accounts.
6. Moving a business out of state.
7. Phishing.
8. Disguised corporate ownership.
9. Return preparer fraud.
10. Trust misuse.
11. Abusive Roth IRAs.
12. Abuse of charitable organizations and deductions.

California's e-service options are ahead of the curve

You have probably heard of MySpace or YouTube, but have you heard of **My FTB Account**? Like MySpace and YouTube, *My FTB Account* is another marvel of Internet technology, and your first stop for viewing PIT taxpayer information and services including:

- The last 25 estimated tax payments.
- Up to 60 recent payments applied to a balance due, total current balance due.
- A summary of up to 10 tax years with a balance due.
- A maximum of four years of California wage and withholding information.
- Up to three years of FTB-issued 1099-G and 1099-INT information.

My FTB Account is just a click away from other valuable taxpayer services like *Web Pay*, where a taxpayer can make payments online and apply for *Individual Electronic Installment Agreements*. We designed *My FTB Account* to be customer-friendly and adaptable for the future

of e-services. Using it can prevent one of the most common errors: claiming the wrong amount of estimated tax payments, which may delay refunds or cause taxpayers to receive unexpected tax bills.

For the future, we are exploring ways to enhance *My FTB Account* to provide true one-stop shopping for all taxpayer assistance services. In addition to the services above, imagine visiting just one site to make a payment, check a refund status, or check an e-file status. We plan to include all of these e-services in *My FTB Account*.

To access *My FTB Account*, go to ftb.ca.gov and enter "my account" in the search field. Check out the [Frequently Asked Questions](#) page for answers to the most common questions.

Notes from the Tax Practitioner Liaison

Tax Practitioner Hotline: Supply and demand

If you called the FTB Practitioner Hotline recently, you may have experienced a delay in getting through. This is nothing new, and is not the result of a budget cut. Connecting to the hotline is always difficult this time of year. We experience a crescendo of calls about personal income tax issues in March and April. In addition, we refer to the first two weeks of March as "March madness" because we receive so many tax practitioner calls requesting that we verify BE estimate tax payments. The first two weeks in March is often the busiest time of year for us. Our agents average 100 calls or more per day. Thankfully, the calls are usually short, but they are virtually nonstop and "queued up" from 8 a.m. to 5 p.m. Compared to last year, we have not reduced the number of staff on the Hotline.

Here's the good news: for a few days after March 17, we typically see a slight decrease in calls. Take note of this for next year's filing season and take advantage of this brief lull to make your calls. It only lasts a few days and then we are very busy again until after April 15. If you can, make your Hotline calls as early as possible in the filing season and avoid March madness. Better yet, avoid the queue altogether for your personal income tax client accounts by visiting [My FTB Account](#) on our Website at ftb.ca.gov. You can view estimated payments any time of the day or night, with no waiting.

Inside FTB

Collection contact center hours change April 1

The business hours for our Business Entities collection, and Lien Resolution contact centers are changing. Beginning April 1, these contact centers will be open from 7:30 a.m. to 5 p.m., Monday through Friday.

Business hours for the Personal Income Tax (PIT) Collection contact center will not change, however. The PIT Collection contact center will remain open from 7:30 a.m. to 6 p.m., Monday through Friday.

Call these numbers for answers to your questions on personal income tax, business entities income tax, and resolving liens:

- Personal income tax collections. 800.689.4776
- Business entities income tax collections. 888.635.0494
- Lien resolution. 916.845.4350

If your client's case is assigned to a specific collections representative, please contact the assigned representative.

For general tax information, our toll-free information service is available from 7 a.m. to 6 p.m., Monday through Friday. Call 800.852.5711 within the United States, or 916.845.6500 from outside the United States (not toll-free).

FTB CIO wins 2008 Director's Award

FTB's Chief Information Officer, Cathy Cleek, was selected to win the 2008 CIO Director's Award, which recognizes outstanding leadership and contributions to state government.

The Director's Award is a special overarching award given to an AIO or CIO who has demonstrated collaboration, partnership, leadership, and communication between business and IT.

The Government Technology Conference sponsors an annual two-day conference for California's Chief Information Officers. As part of the California Public Sector CIO Academy 2008 Conference, one award is given in each of five categories:

- Organizational Collaboration.
- Outstanding Customer Service.
- Leadership.
- Communication.
- Director.

Criminal Corner

We are committed to closing California's \$6.5 billion tax gap, defined as the difference between tax that is owed, and tax that is paid. Our special agents work cooperatively with law enforcement agencies throughout California to uncover illegal behaviors that contribute to the tax gap. These include underreporting income, overstating deductions, failing to file returns, failing to pay taxes due, and making illegal cash payments to employees.

Tax fraud is not a victimless crime. You can report suspected tax fraud by calling FTB at 800.540.3453.

Former collections manager guilty in embezzlement scheme

On February 26, a former collections manager pleaded no contest to embezzling more than \$323,000 from his former employer.

Patrick J. Roche, 33, was found guilty of felony counts of grand theft, with a special enhancement for a loss involving more than \$150,000. He was also found guilty of two state income tax charges: tax evasion for failing to file his 2004 tax return, and tax fraud for filing a fraudulent 2006 income tax return. According to court documents, Roche created a fictitious company, Cal Computer Consulting Group, to embezzle from his former employer, a Santa Barbara-based temporary employment agency, from 2001 – 2007.

Roche issued fraudulent invoices from his company, then authorized payment as collections manager. He cashed the checks and used the money at restaurants, bars, adult entertainment, a kickboxing gym, online gaming, and stock purchases. In addition, Roche failed to report the \$314,000 in illegal income on his state income tax returns. All income is taxable including income from illegal sources. The embezzlement was discovered during an audit of the company's books.

Roche was ordered to pay restitution of \$323,962 to his former employer, and \$59,577 to FTB representing the unpaid tax, penalties, interest, and the cost of the investigation. Roche faces up to four years in state prison.

Emergency room physician arrested on state income tax evasion charges

FTB special agents arrested a Big Bear City physician on numerous felony charges of state income tax evasion, on February 29.

Norman E. Johnson, 60, a.k.a Eric N. Johnson and N. Eric Johnson, is employed as an emergency room physician by a Victorville hospital. Secretary of State records show Johnson is also listed as the corporate executive officer of N. Eric Johnson, M.D., M.P.H., A Professional Corporation. This corporation is currently suspended for failing to file its state income tax returns.

According to FTB special investigators, Johnson allegedly failed to file his 2001 – 2005 state income tax returns on the more than \$1.8 million income he earned. In addition, Johnson allegedly failed to file his 2001 – 2005 corporate income tax returns reporting the more than \$1 million in income his corporation earned. Johnson owes the state more than \$157,000 in personal income tax and \$16,000 in corporate tax. Penalties, interest, and the cost of the investigation will be added to these figures. Each count of failure to file carries a maximum sentence of three years in state prison.